

March 13, 2022

Margin pressure to get further elongated; long-term outlook stays intact...

International coal prices have seen a sharp uptick with South African coal doubling to \$446 in just 10 days due to Russia-Ukraine crisis. Currently international coal prices are hovering at \$370+/tonne, still up 106% from Q3FY22 exit rate and 4.2x higher on a YoY basis. Petcoke prices are also up over 100% YoY, 11% QoQ and currently hovering at ~\$225/tonne. Although these steep rises in prices are unsustainable in the long run, these would put cement companies again on the back foot in terms of operating rates at least till the time the situation comes back to normalcy as power & fuel accounts for 27% of total costs. Since most cement companies have average two months of fuel inventories, we will see full impact of the cost escalations from Q1FY23E onwards. However, companies with higher domestic coal linkages will be least affected. Apart from higher coal/petcoke prices, the recent increase in crude prices may also lead to a rise in the freight costs. Overall, we expect cement sector margins to decline 98 bps in Q4FY22E and further by 498 bps in FY23E. Despite these ongoing cost related challenges, demand outlook is expected to stay healthy from long-term perspective. With recent marketwide sell-offs, valuations of many cement companies have now come down to compelling levels on EV/tonne basis (Exhibit-12) making them attractive from a long-term perspective.

Expect further price hikes soon...

Cement prices has increased by ₹ 15-17/bag during January-February 2022 at all India level. However, the same was not enough given the continued uptrend in the cost of production. The key reason for lower than required price hikes were due to moderation in rural demand on account of high inflationary environment, temporary slowdown in the execution of infrastructure projects and state elections in few states such as Uttar Pradesh, Punjab. etc. As per our workings, further price hike of ₹ 35-40/bag would be required during March-June 2022 just to sustain EBITDA/t at Q3FY22 levels, of which we expect price hikes of ₹ 20-25/bag to be announced soon.

...as Q3FY22 has already witnessed 20.3% YoY drop in EBITDA

The industry witnessed a difficult quarter due to cost escalations coupled with a weak demand scenario on account of unseasonal rains along with festive season during Q3FY22. Petcoke/international coal and diesel prices (~55% of costs) saw a sharp uptick with 92%, 211% and 18% increase YoY, respectively. On QoQ basis also, prices of petcoke, international coal were up 25-30%. This led to an increase in the cost of production by another ₹ 302/t QoQ to ₹ 4,552/t (up 17.4% YoY, 7.1% QoQ). Further unseasonal rains during October-November, sand mining ban in east, along with labour scarcity issues due to festive season have affected retail demand. Hence, price hikes taken in October 2021 were rolled back partially. Overall, cement prices were up only 1.1% QoQ. As the price increase was not enough to pass on the cost pressure, average EBITDA/t saw a meaningful drop of 20.3% YoY, 20.1% QoQ.

Prefer companies with strong balance sheet/reasonable valuations;

Factoring in higher costs, we reduce our aggregate EBITDA estimate by 4.6%, 20.5% for FY22E, FY23E, respectively, for our cement universe. Accordingly, we cut target prices in the range of 15-25%. Companies operating with higher than average industry costs would tend to find it difficult to navigate in the medium term. Despite these challenges, we maintain our positive stance on the sector from long-term view as current elevated international coal/petcoke prices are unsustainable while positive demand outlook continues to stay intact in our view. The strong gross budgetary support for infra in the recent budget, pick-up in the urban real estate and healthy rural demand backed by good Rabi-crop season would remain key levers for healthy demand growth going forward. Valuations of many cement companies have now come down ~25-30% below their replacement levels, making them attractive from long-term perspective. UltraTech Cement and ACC continues to remain our top picks in the large caps while we prefer JK Lakshmi and Sagar Cement in the midcap space.

Recommendation Matrix				
Company	Rating		TP(₹)	Upside
	Old	New		
ACC	BUY	BUY	2480	21%
Ambuja	BUY	BUY	350	19%
Birla Corp	BUY	HOLD	1320	14%
Heidelberg	HOLD	HOLD	225	15%
JK Cement	HOLD	HOLD	2640	15%
JK Lakshmi	BUY	BUY	580	26%
Mangalam	BUY	BUY	425	25%
Ramco	BUY	BUY	900	23%
Sagar	BUY	BUY	300	43%
Shree	HOLD	HOLD	25700	15%
UltraTech	BUY	BUY	8000	33%

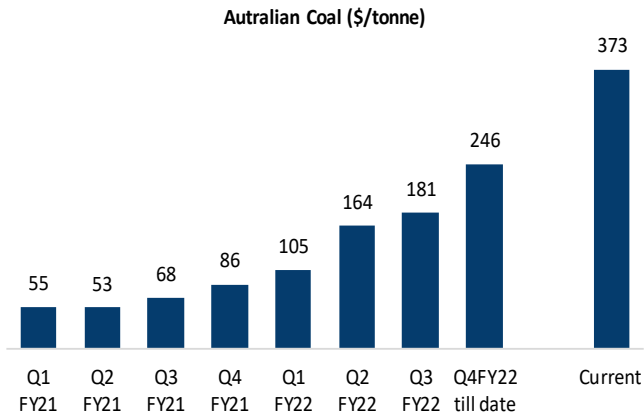
Key risks

- 1) Persistent weak cement prices
- 2) Moderation in the retail demand due to inflationary pressure

Research Analyst

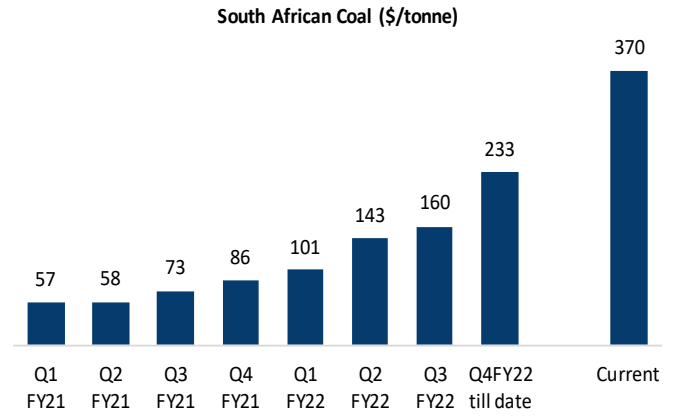
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Exhibit 1: Australian coal price trend



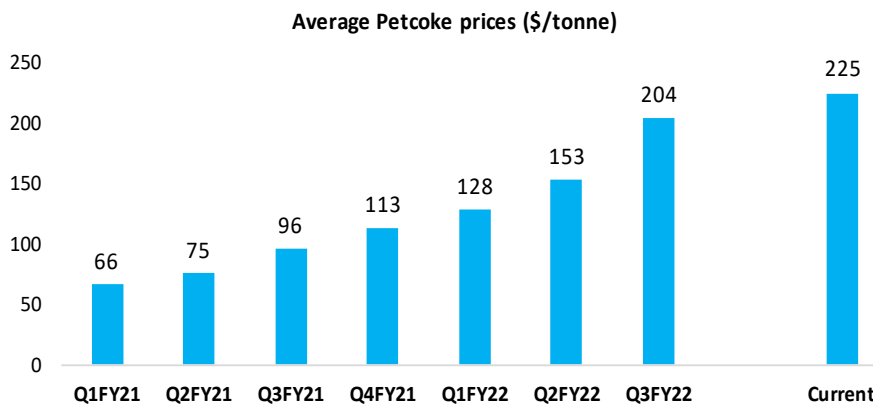
Source: Bloomberg, ICICI Direct Research

Exhibit 2: South Africa coal price trend



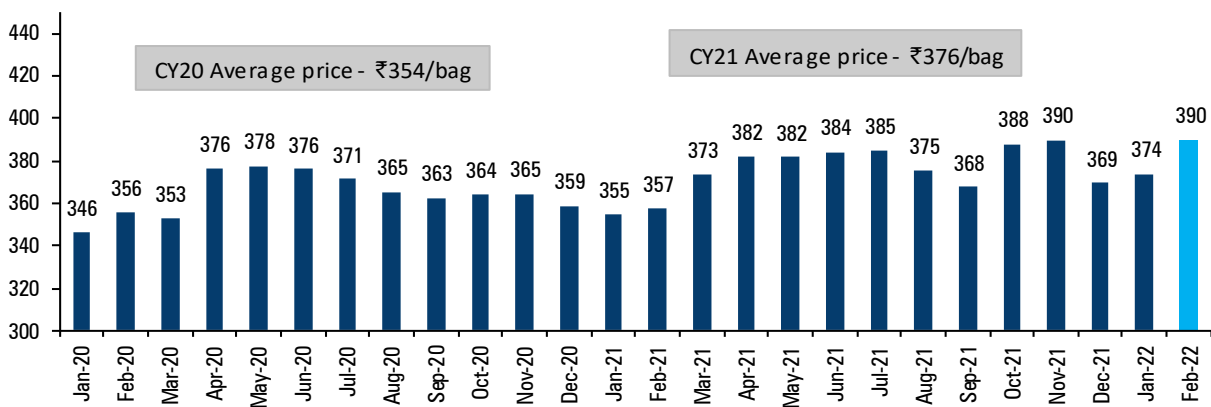
Source: Bloomberg, ICICI Direct Research

Exhibit 3: Petcoke prices



Source: ICICI Direct Research

Exhibit 4: Past three years cement price trend (retail) at all-India level



Source: Crisil Research, ICICI Direct Research

Exhibit 5: Rating matrix and Target price

Company	CMP	Rating		Target		
		Old	New	Old	New	Upside
ACC	2050	BUY	BUY	2850	2480	21%
Ambuja Cement	293	BUY	BUY	430	350	19%
Birla Corp	1156	BUY	HOLD	1650	1320	14%
Heidelberg Cement	196	HOLD	HOLD	285	225	15%
JK Cement	2300	HOLD	HOLD	3750	2640	15%
JK Lakshmi Cement	460	BUY	BUY	700	580	26%
Mangalam Cement	340	BUY	BUY	600	425	25%
Ramco Cement	732	BUY	BUY	1130	900	23%
Sagar Cement	210	BUY	BUY	315	300	43%
Shree Cement	22400	HOLD	HOLD	28700	25700	15%
UltraTech Cement	6020	BUY	BUY	9300	8000	33%

Source: ICICI Direct Research

Exhibit 6: Target valuation

Company	EV/EBITDA		EV/tonne (\$)	
	FY22E	FY23E	FY22E	FY23E
ACC	16.2	10.2	139	137
Ambuja Cement	13.0	11.5	194	164
UltraTech Cement	21.0	19.1	245	241
Shree Cement	24.7	22.8	272	234
Ramco Cement	19.6	18.5	185	175
Heidelberg Cement	14.2	12.0	116	114
JK Cement	15.7	17.0	178	156
JK Lakshmi Cement	11.5	13.1	78	81
Sagar Cement	15.7	10.0	74	73
Mangalam Cement	7.1	5.1	56	51
Birla Corp	14.2	11.8	103	101

Source: ICICI Direct Research

Exhibit 7: Power & fuel costs likely to increase further by ~14% QoQ in Q4FY22E and ~19.7% in FY23E

P&F cost analysis	Quarterly trend				Yearly trend			
	Q1FY22	Q2FY22	Q3FY22	Q4FY22	FY21	FY22E	Current	FY23E
Cost per Tonne (\$)								
Petcoke	160	163	186	213	87	173	225	200
Imported coal	89	117	152	264	67	155	370	250
Domestic Coal	71	74	93	101	76	85	101	105
Cost per Tonne (₹)								
Petcoke	11,987	12,193	13,916	15,955	6,562	12,975	16,875	15,000
Imported coal	6,656	8,794	11,367	19,800	5,029	11,654	27,750	18,750
Domestic Coal	5,347	5,562	7,005	7,550	5,700	6,366	7,550	7,875
Cost on Kcal basis (₹)								
Petcoke -7700	1.56	1.58	1.81	2.07	0.85	1.69	2.19	1.95
Imported coal - 5500	1.21	1.60	2.07	3.60	0.91	2.12	5.05	3.41
Domestic Coal - 4500	1.19	1.24	1.56	1.68	1.27	1.41	1.68	1.75
Fuel Mix (%)								
Petcoke	20%	60%	50%	50%	60%	50%	50%	50%
Imported coal	60%	25%	20%	10%	30%	20%	10%	10%
Domestic Coal	20%	15%	30%	40%	10%	30%	40%	40%
Blended fuel cost per Kcal	1.3	1.5	1.8	2.1	0.9	1.7	2.3	2.0
P&F cost								
Fuel	893	1,075	1,249	1,447	639	1,183	1,590	1,410
Power	225	240	231	240	231	263	300	320
Total P&F cost based on current price trend	1,118	1,315	1,480	1,687	870	1,446	1,890	1,730
(QoQ increase)		17.6%	12.6%	14.0%		66.3%		19.7%

Source: Company, ICICI Direct Research

At present, international coal prices are hovering at ₹ 5.0/Kcal, which is substantially up 146% from Q3FY22 levels. Hence, cement companies would now shift aggressively towards higher usage of domestic coal & petcoke which are currently available at ₹ 1.68 and ₹ 2.19 on a per Kcal basis, post exhaustion of their existing fuel inventories. Assuming fuel mix of 50% petcoke and 40% domestic coal (vs. 60% petcoke, 30% imported coal and 10% domestic coal earlier), we expect P&F cost of the sector to increase further by 19.7% in FY23E.

On a per tonne basis, every \$10/tonne rise in fuel costs, has cost impact of ₹ 3-3.5/bag. Hence, additional price increase of ₹ 35-40/bag is required just to offset the incremental cost impact of P&F costs. Till date, cement prices have increased by only ~₹-1517/bag. The same is not enough. Now, with favourable state election outcome, we expect cement demand to improve led by pick-up in the infra, that should open the space for players to take second round of price hikes. While a substantial price increase is unlikely, **we are factoring price hike of ₹ 20-25/bag to be taken soon.** Taking this into account, we still expect EBITDA/t of our coverage universe for FY23E to drop by 20.3% (Exhibit-9) from our earlier estimates assuming petcoke and imported coal price averages at \$200 & \$250 respectively. We now build in sector EBITDA margin of 17.7% for FY23E vs 22.7% projected earlier.

Every \$10/tonne rise in the cost of imported fuel (coal/petcoke) increases P&F cost by ~₹ 65/tonne or ~₹ 3.5/bag assuming its 50% share in the total fuel mix.

Exhibit 8: Changes in revenue estimates

Company	Old		New		Change in estimates	
	FY22E	FY23E	FY22E	FY23E	FY22E	FY23E
ACC*	16,152	17,515	16,152	17,850	NA	1.9%
Ambuja Cement*	15,813	16,933	15,891	17,019	NA	0.5%
Birla Corp	7,478	9,006	7,514	9,121	0.5%	1.3%
Heidelberg Cem	2,298	2,558	2,286	2,604	-0.5%	1.8%
JK Cement	7,678	8,268	7,697	8,561	0.2%	3.5%
JK Lakshmi Cem	5,000	5,469	5,006	5,675	0.1%	3.8%
Mangalam Cem	1,524	1,762	1,524	1,797	0.0%	2.0%
Ramco Cement	6,086	7,234	6,031	7,400	-0.9%	2.3%
Sagar Cement	1,604	2,406	1,606	2,432	0.2%	1.1%
Shree Cement	14,461	17,057	14,500	17,102	0.3%	0.3%
UltraTech Cement	51,690	58,817	51,812	60,025	0.2%	2.1%
Total	129,783	147,026	130,018	149,587	0.2%	1.7%

Source: ICICI Direct Research

With additional price hike than earlier estimates, we increase our revenue forecast by ~1.7% for FY23E

Exhibit 9: Changes in EBITDA estimates

Company	Old		New		Change in estimates	
	FY22E	FY23E	FY22E	FY23E	FY22E	FY23E
ACC	2,998	3,255	2,998	2,353	NA	-27.7%
Ambuja Cement	2,851	3,975	2,851	2,959	NA	-25.6%
Birla Corp	1,215	1,780	1,049	1,235	-13.7%	-30.6%
Heidelberg Cement	402	543	360	416	-10.5%	-23.3%
JK Cement	1,584	1,777	1,459	1,382	-7.9%	-22.2%
JK Lakshmi Cement	740	841	652	596	-11.9%	-29.1%
Mangalam Cement	240	397	222	280	-7.7%	-29.6%
Ramco Cement	1,352	1,751	1,276	1,339	-5.6%	-23.5%
Sagar Cement	311	537	272	420	-12.5%	-21.7%
Shree Cement	3,832	4,587	3,654	3,936	-4.6%	-14.2%
UltraTech Cement	11,189	13,893	10,688	11,575	-4.5%	-16.7%
Total	26,715	33,336	25,482	26,491	-4.6%	-20.5%
Margin (%)	20.6	22.7	19.6	17.7	-98bps	-498bps

Source: ICICI Direct Research

Exhibit 10: Changes in EBITDA/t estimates

Company	Old		New		Change in estimates	
	FY22E	FY23E	FY22E	FY23E	FY22E	FY23E
ACC	1,038	1,044	1,038	755	NA	-27.7%
Ambuja Cement	1,187	1,342	1,187	999	NA	-25.6%
Birla Corp	847	1,043	731	724	-13.7%	-30.6%
Heidelberg Cement	830	1,014	743	778	-10.5%	-23.3%
JK Cement	1,174	1,214	1,082	944	-7.9%	-22.2%
JK Lakshmi Cement	714	748	629	531	-11.9%	-29.1%
Mangalam Cement	753	1,088	696	766	-7.7%	-29.6%
Ramco Cement	1,206	1,323	1,138	1,012	-5.6%	-23.5%
Sagar Cement	870	1,038	761	812	-12.5%	-21.7%
Shree Cement	1,399	1,449	1,334	1,243	-4.6%	-14.2%
UltraTech Cement	1,236	1,362	1,181	1,134	-4.5%	-16.7%
Avg EBITDA/t	1,161	1,264	1,106	1,008	-4.7%	-20.3%

Source: ICICI Direct Research

Every \$10/tonne change in the cost of imported fuel (coal/petcoke) leads to cost impact of ₹ 3-3.5/bag in the cost assuming 50% share in the total fuel mix

Exhibit 11: Current valuation at EV/EBITDA level

	Old		New	
	FY22E	FY23E	FY22E	FY23E
ACC	10.4	9.8	12.8	8.0
Ambuja Cement	12.6	11.0	10.7	9.3
UltraTech Cement	15.9	12.4	16.8	15.1
Shree Cement	20.1	16.5	21.5	19.8
Ramco Cement	15.4	11.6	16.5	15.6
Heidelberg Cement	7.5	6.1	12.4	10.5
JK Cement	12.5	11.2	13.9	15.0
JK Lakshmi Cement	7.3	5.8	9.4	10.7
Sagar Cement	10.3	5.7	11.8	7.5
Mangalam Cement	5.7	3.4	6.1	4.3
Birla Corp	7.5	5.6	12.7	10.5

Source: Company, ICICI Direct Research

Exhibit 12: EV/tonne now at compelling levels

	Old		New	
	FY22E	FY23E	FY22E	FY23E
ACC	132	122	116	107
Ambuja Cement	181	153	161	135
UltraTech Cement	289	248	195	191
Shree Cement	263	225	235	203
Ramco Cement	177	166	155	147
Heidelberg Cement	127	121	101	99
JK Cement (Adjusted)	217	219	158	139
JK Lakshmi Cement	75	75	63	66
Sagar Cement	61	58	56	54
Mangalam Cement	56	49	48	43
Birla Corp	137	97	94	92

Source: Company, ICICI Direct Research

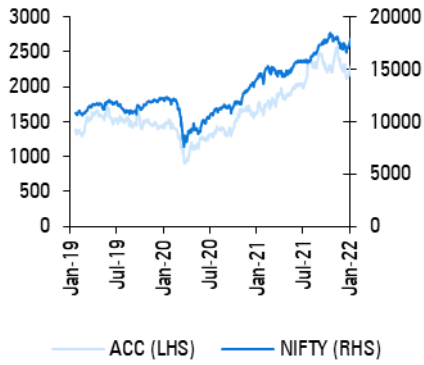
Exhibit 13: Valuation matrix (Cement – coverage universe)

Company	CMP		Rating	EPS(₹)			EV/EBITDA (x)			EV/Tonne (\$)			RoCE (%)			RoE (%)		
	(₹)	TP(₹)		FY21	FY22E	FY23E	FY21	FY22E	FY23E	FY21	FY22E	FY23E	FY21	FY22E	FY23E	FY21	FY22E	FY23E
ACC*	2,050	2,480	BUY	85	102	78	10.0	12.8	8.0	124	116	107	14.7	17.6	13.5	12.6	13.4	10.1
Ambuja Cem*	293	350	BUY	9	10	11	11.5	11.7	9.3	158	161	135	18.6	17.8	17.6	21.0	20.6	20.4
UltraTech Cem	6,020	8,000	BUY	185	202	206	16.4	16.8	15.1	197	195	191	14.7	13.2	14.2	12.7	12.2	11.3
Shree Cement	22,400	25,700	HOLD	641	597	599	20.0	21.5	19.8	233	235	203	18.2	15.7	14.9	15.2	12.7	11.5
Heidelberg Cem	196	225	HOLD	14	8	11	9.4	12.4	10.5	103	101	99	20.1	15.7	19.7	21.1	12.6	15.2
JK Cement	2,296	2,640	HOLD	78	96	77	13.0	13.9	15.0	132	158	139	18.6	16.1	13.2	20.6	17.0	12.3
JK Lakshmi Cen	460	580	BUY	31	26	18	7.2	9.4	10.7	62	63	66	21.1	15.8	12.8	19.0	14.2	9.6
Birla Corp	1,156	1,320	HOLD	88	35	41	9.9	13.0	10.8	121	94	92	10.8	6.5	7.2	12.4	5.0	5.5
Ramco Cement	732	900	BUY	32	25	26	13.0	16.5	15.6	149	155	147	8.6	6.5	6.3	13.5	9.5	8.9
Sagar Cement	210	300	BUY	16	7	15	7.5	11.8	7.5	75	56	54	15.6	8.5	14.8	16.0	6.8	12.6
Average							13.8	13.6	11.7	126	124	116	14.1	12.6	13.0	13.6	11.5	11.4

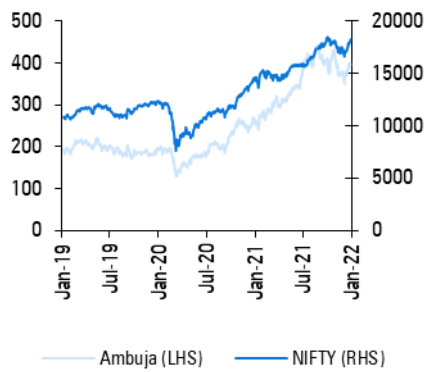
Source: ICICI Direct Research

Exhibit 14: Price Charts

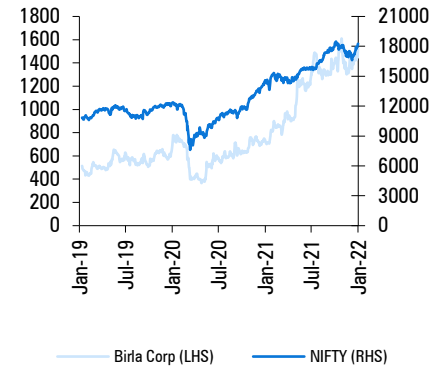
ACC Limited



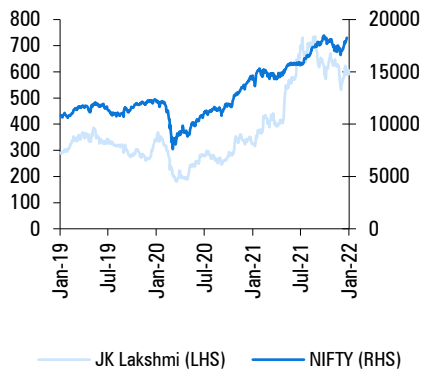
Ambuja Cement



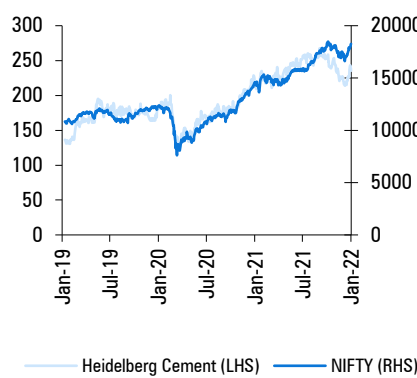
Birla Corp



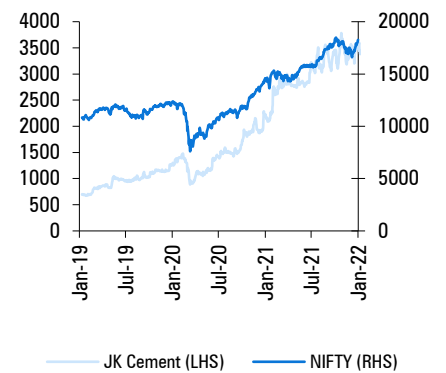
JK Lakshmi Cement



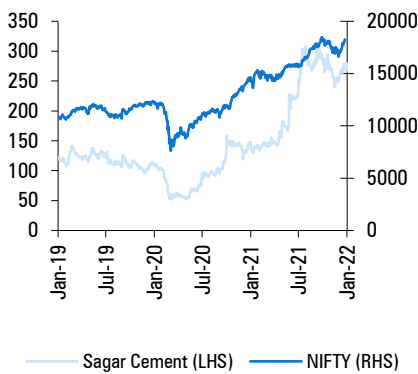
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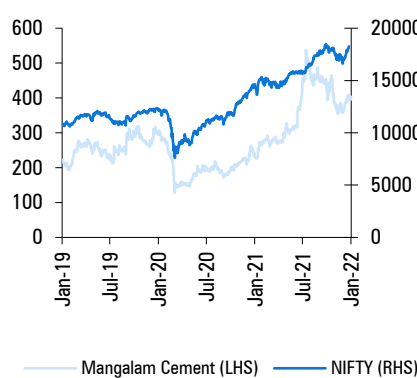
JK Cement



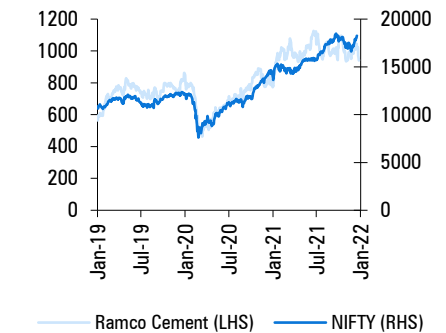
Sagar Cement



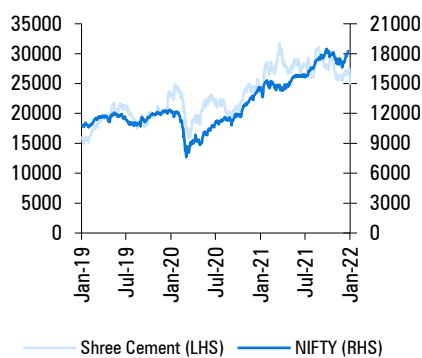
Mangalam Cement



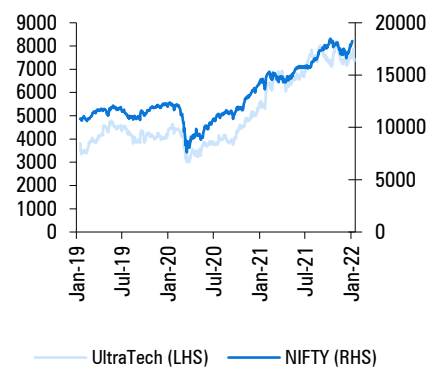
The Ramco Cement



Shree Cement



UltraTech Cement



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